RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Nov. 2, 1988 **LETTER 1003**

Oct 21 DJIA 2183.50; PTI 2807; A-D Ratio -10.19
Oct. 28 DJIA 2149.89; PTI 2807; A-D Ratio -10.77
Current Dow Yield: 3.60; Dow P/E: 12.8
Dow 200-day moving average: 2050; DowPow: 858
Percentage of undervalued blue-chips: 18%.

THE LEVERAGING OF AMERICA: I've been saying it all along, but I'll repeat it. Subscribers are going to have to be very PATIENT with this bear market. The world today is geared to big bucks, to instant winning, to leveraged buyouts, to making the list of "100 richest Americans." We read about Donald Trump buying the Plaza Hotel for $400 million, we read about KKR bidding $20.6 billion for RJR Nabisco, we read glossy magazines telling us what's hot -- hot people, hot stocks, hot clothes, hot restaurants, hot concepts, hot money.

Today, the corporate world has turned into a giant crap game, with every corporation, no matter how large, subject to a takeover or an LBO. In this market, the mere rumor of a takeover can send a stock up 20% or more overnight. Said an excited investment banker quoted in *USA Today*, "I still think GM and Sears are too big but it's wild. It's like . . . anything goes."

The amount of money available for LBOs (which totaled $100 million in 1980) now is roughly $250 billion. Depite what most people think, the new money is not coming from the rich. Much of it comes from the pension funds of millions of American workers and retirees. According to Fed statistics, pension fund assets are now near $2 trillion. Money is also coming from some of the most conservative banks, banks which five years ago would not have touched an LBO financing. And lastly, the Wall Street brokerage firms, which are suffering from a profit famine, want a share of the new fast bucks. Today, everyone, the lawyers, the bankers, the brokerage houses, the funds, the inisders, they all want in on the action. The track record of the boys who are leveraging America is staggering, and greed once again reigns supreme in the land.

Where will it all end? It will end where all speculative manias ultimately end -- in disappointments, collapses, scandals, law suits, and bankruptcies. In the mean time, it's the only game around, and Wall Street is obviously enthralled by the new super high-stakes action.

In the upper right on this page you'll notice a statistic that I consider critically important. It's the percentage of undervalued blue-chip stocks on the NYSE. The latest count (courtesy of *IQ Trends* here in La Jolla) shows that the percentage of undervalued blue-chips has now dropped to 18%. In other words, fewer than one out of every five blue-chip stocks is currently undervalued.

"All right, Russell," you ask, "then why don't we just buy the undervalued blue-chips?" And my answer is that this isn't a game we're playing, this isn't a dress rehearsal for life. I'm talking about real money, your money and my money, and I'm not in the business of playing craps with my life savings. And I'm not selling excitement and thrills in these reports, I'm selling correct investment procedure, investment procedure that has withstood the test of time.

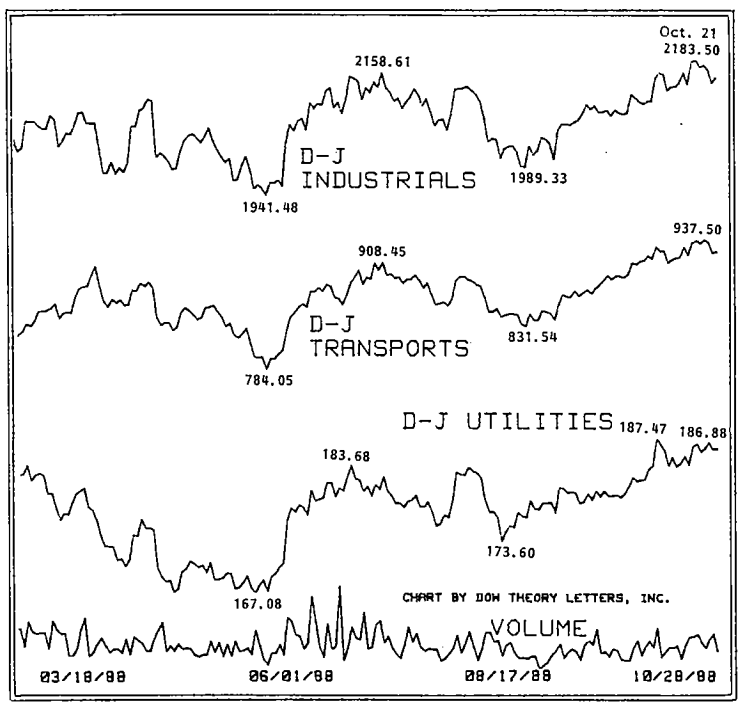
The real meaning of the 18% of undervalued blue-chips is that from a value standpoint this market is again in a top area. Letter I001 included a chart showing the undervalued blue-chip index going back to 1966. The chart shows that once the undervalued index moves into the area of tops at 12% to 17%, the next major, long-term move is to the area of bottoms, at which time the undervalued index will rise to around 70%, 75% or on occasion even above 80%.

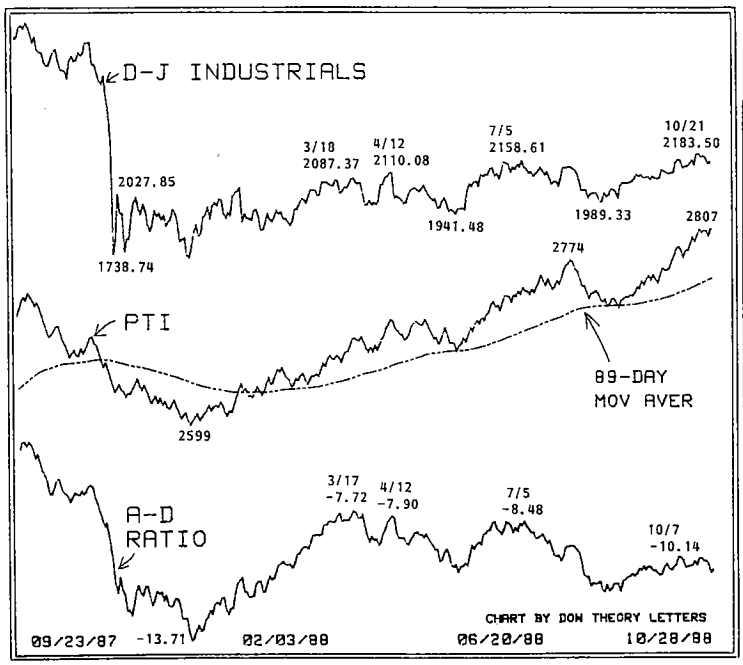
Furthermore, in the last Letter I included an updated version of Edson Gould's "Senti-meter," and here again we see that the market, based on dividend yield on the Dow, is in a high area bordering between "enthusiasm" and "confidence." Now an area between confidence and enthusiasm just isn't where bear markets end -- and it isn't where bull markets start. No, the Senti-meter again shows us that the stock market is in a high area, an area which has correlated with many bull market tops of the past.

I spent a lot of time on the Dow Theory section of the last Letter. One of the reasons I wrote that section is that I wanted subscribers to realize how important the concept of VALUES is in dealing with the stock market. Ultimately, everything in the stock market revolves around values. Values show you where you are, values identify the overall (primary) trend, great values are what brings informed investors into the market, while thin values send informed investors to the exits.

On October 10, the averages rose to new post-crash recovery highs, and this again brought out cries of "new bull market" from a chorus of "experts." My position, stated repeatedly, is that the bull market ended in August 1987 and those proclaiming "a new bull market" may be well-intentioned, but they don't know or understand Dow Theory. Neither do they know that no bull market in history ever began with the yield on the Dow in the 3.7% area.

When the next bull market does begin, it will start from an area of great values, and one test of values will be the yield on the Dow, which will be around 6% or more. Other characteristics of a bear market bottom will be very low volume, collapsed blue-chip





stocks, literally no market for second-grade issues, black pessimism on the part of investors, and pronouncements by headline-grabbing know-nothings that "the market will cut itself in half from here."

The advance-decline ratio on the NYSE continues to perform poorly (I should say ominously). The post-crash recovery high was recorded last March 17, and the A-D has been diverging with the Dow ever since. In fact, the Dow/A-D divergence is now assuming historic proportions with the divergence continuing for a time-span of almost eight months. The price/breadth divergence is shown on the page 2 chart, and this is a chart that is well worth studying.

Note on the chart that since the last Letter another link in the price/breadth divergence has appeared. The latest instance occurred when the Dow on October 21 rallied to a new recovery high of 2183.50 while the A-D ratio pushed to a fifth lower peak at minus 10.19, and this is the fifth non-confirmation between the Dow and the A-D ratio since March 17.

In the last Letter I discussed four previous periods in which the Dow and the A-D had parted company for a periods of four months or longer. None of these periods of divergence had a happy ending. I doubt whether the present area will do any better.

The question might be asked, "Why is market breadth lagging so badly in an economy that seems to be booming?" My answer is that despite the fact that many blue-chip stocks are doing well, despite that fact that takeover fever is rampant on Wall Street, despite the rosy forecasts of economists, the majority of stocks on the NYSE are telling us a different story. The overall trend of the majority of stocks, as measured by the A-D ratio, has been down since last March. Why this has occurred, we will probably learn as the bear market wears on.

Furthermore, what is so striking to me is not just the fact of the price/breadth divergence itself -- it's the persistence of the divergence. Month after month, every new recovery high in the Dow is greeted by a still lower peak in the A-D ratio. This has been going on for almost eight months. It's an incredible example of the market shouting "danger" in the face of the "good news"

Here's a thought that has occurred to me: If this were a bull market the current takeover frenzy on Wall Street would be almost guaranteed to send the stock market rocketing higher. It's most significant that with all this takeover excitement, the general market has been ignoring what is going on. In fact, it would seem that stocks are being distributed under the curtain of speculative frenzy in the takeover candidates. (See **Late Notes** on page 6 for final observations on the market).

INVESTMENT POSITION: Ever since the highs of last year I've been telling my subscribers (1) to be out of stocks, (2) to respect the bear, and (3) to collect interest on money instruments. From what I gather from letters received here, a great majority of my subscribers have done just that. Actually, the process has been painless. Total return on bonds has been juicy, the return on money funds has been generous, and the stock market has been exasperating.

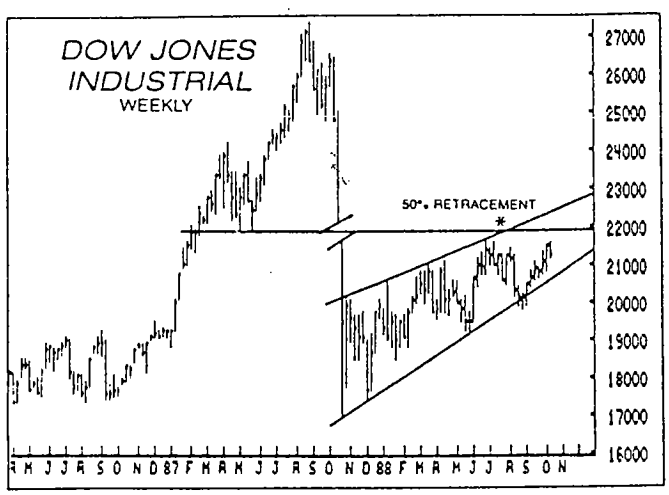
Almost every business publication I read is congratulating itself or the nation on the fact that the crash of '87 "didn't touch the economy." The crash was just a mistake, a distant memory we are told -- but I don't believe that for a moment.

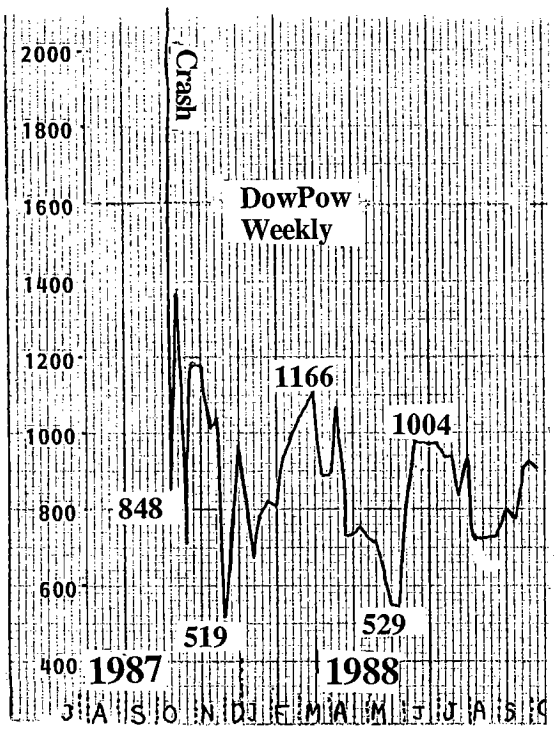
Meanwhile, Wall Street, starving for commissions and profits, has been doing what it always does during a primary bear market -- contracting. History tells us that Wall Street leads and the rest of the nation follows. Maybe not in a month or six months or even a year - but the nation will follow. The bear continues to be master of the box.

TWO CHARTS: Nothing is more difficult in this business than obtaining a long-term perspective. Keynes noted sarcastically that "in the long term, we are all dead." An incontrovertible truth, but it is also true that in the long term a lot of money is made on Wall Steet, and a lot is lost.

The first chart shows the Dow during the period of 1987 to date. Here we see the Dow, following the crash, correcting on the upside for over a year. But despite the one-year upside correction the Dow has been unable to regain even half the losses of the first part of the bear market (i.e., the losses of August to October of 1987). Furthermore, the rise has assumed the form of a rising wedge pattern, a pattern that is characteristic of bear market rallies.

The second chart shows my proprietary index, DowPow. DowPow is the Dow adjusted (daily) for the action of the advance-decline ratio. This is a concentrated chart showing DowPow on its Friday closings only. What is so fascinating to me is the persistent sideways action of DowPow. What DowPow is indicating is that the recovery from the crash has been very weak. In fact, if one just examined this two-year chart one might think that DowPow was incapable of rallying strongly. But that's hardly the case as veteran readers of these Letters know. (For instance, DowPow exploded on





the upside during the period of 1982 to 1987 as shown on the long-term chart in Letter 996.)

QUESTIONS, ANSWERS: Question: Russell, you say we're in a bear market. What do you think is causing the bear market, or, to put it another way, what do you think the bear market's all about?

Answer: The answer to the first part is easy. What's causing the bear market is more powerful sellers than buyers. Large interests were moving out of the stock market all during 1987, and they are continuing to move out -- under the protective screen of "a rosy economy" and the excitement of the takeover frenzy. Today's "good news" economy is providing the sellers with a trading range market which they can sell into. So, as far as today's rosy economy is concerned, it's a blessing for those who want to sell stocks.

The second part of the question is far more complex, but here's what I see. There's no way in the world that the US can continue, year after year, to spend more than it saves and consume more than it produces. This process has been going on for longer than many thought possible, but I believe the end is in sight. President Reagan (the luckiest president who ever lived) somehow got away with avoiding the deficit problems. I'm convinced that our next president (almost surely Bush) will have to deal with the problems. If the problems are not dealt with, our creditors will force Bush and the Congress to deal with it.

The way to attack the problem is as follows: (1) The US must embark on a program of consuming less than it produces, and (2) Americans not only have to consume less, they have to save more. The Japanese save 20% of their income, the Germans 10%. Americans save 4%. On top of that Japan boasts a 23% rate of investment in plants and equipment, far above the US rate. With those statistics in mind, how can the US think that it can go on and on with its consumption boom -- all the while borrowing $billions from foreigners to finance the over-consumption? The answer is that the US can't go on this way indefinitely. But it's going to be painful, very painful, to reverse the tide.

By the early 1990s the total imbalance between US and foreign investments will hit $1 trillion. This will mean an annual transfer of $40 to $50 billion overseas just to service our debt to foreigners. This is money that will not be available to Americans. It means profits and jobs lost to our creditors overseas. Already the adverse trade balance has cost 5 million American jobs.

On top of that, the US must start cutting its federal deficits. If we don't, somewhere down the line our overseas lenders are going to halt their lending. No nation can be expected to pour its assets into a bottomless pit. The US deficit–machine is turning into a bottomless pit.

Below is the record of the national debt and the interest paid on this debt during the Reagan years (figures are in $billions). Does anyone in his right mind believe that we can continue to compound debt in this way?

Year	Debt	Interest
1980	$ 937	$ 53
1981	1,035	69
1982	1,202	85
1983	1,415	90
1984	1,667	111
1985	1,950	129
1986	2,219	136
1987	2,435	143
1988	2,576	148

The big problem, as I see it, comes when the consumption cut-back starts and when the US savings rate begins to rise. All that would be fine if this nation were in a strong financial position with a low debt structure. But the problem is that America is leveraged to the hilt and a recession would create havoc. We can see the tip of the problem in the Southwest and in Denver (both areas heavily dependent on an oil economy). When oil came down, so did the Southwest's economy. We also see the picture in the thrift industry. When interest rates went up, the thrifts (which had lent long at lower rates) became basket cases.

And all this is occurring while the nation is basically enjoying good business. So I ask myself, what happens when the US has to move toward austerity? What happens when our creditors tell us to tighten the screws?

That's what I believe this bear market is going to be about. It will be about turning the picture around, cutting expenses, becoming more conservative, saving again, working hard again, eating nine out of 10 meals at home again, and becoming the productive, competitive nation that we used to be. And believe me, the problems can't be solved simply by letting the dollar slide a little further. Over the past five years the dollar has been cut in half in terms of the major foreign currencies and our trade balance is still horrendously out of whack. No, a weak dollar is not going to do it. It's not going to be that easy.

After a long binge on drugs (inflation), you get off drugs by taking the pain. And that's what every administration since WW II has been avoiding -- the pain of getting off the inflation and deficit bandwagon.

Question: Russell, from the beginning you've said that this bear market would be "long, extended, tedious, deceptive." So far you've been right. But what did you base your opinion on?

Answer: I based my opinion partly on intuition. But there were some other factors. First, the last major bear market during 1973-74 was violent, persistent, and fairly easy to follow. I turned bearish in early 1973 and stayed bearish all the way down until December 1974. There were few deceptive moves in that bear market.

The stock market seldom gives you a repeat performance. Therefore, I felt that this bear market would differ markedly from 1973-74 in that it would be dragged-out, tedious, and very deceptive.

Furthermore,, I felt that this bear market was going to be much more dangerous than 1973-74 in that it involved a lot more debt and speculation (speculation in the form of leveraged buy–outs, junk bonds, takeovers, etc). They say that "the bigger they come, the harder they fall." I think that adage is going to apply to this bear market. But it's going to take a lot of time.

Finally, it's clear that the government will fight this bear market tooth and nail. The Fed knows how tenuous the current financial

situation is. Therefore, the Fed will do its damnest to hold the market and economic structure together. In fact, the US is even going to try to hold the world structure together, as witness the announcement (Oct. 18) that the US will loan bankrupt Mexico $3.5 billion of the taxpayers' money. Tens of billions of dollars will be pitted against this bear market. And that will mean that it's going to be a long, dragged-out bear market. In the end, the result will be the same if not worse. It will be worse because the government will have used up so much ammunition in fighting the bear.

Question: What effect do you think all these leveraged buyouts will have on the markets?

Answer: On October 26 Fed Chairman Greenspan told the Senate Banking Commitee that the Fed has cautioned the banks to consider how their LBO loans might fare during a recession. That's how Greenspan feels about the billions of dollars being put up for buyouts. Fed member Robert Heller on the same day stated that the huge LBO debt loads create "two sources of weakness": (1) They require large cash flows to service the debt, and (2) since the interest rates on many of these debts are variable, the debt service costs are subject to violent increases.

An interesting current example of what's going on is seen in the Kraft move to stay independent. Kraft will pay its shareholders $110 a share in a combination of cash and junk bonds. Kraft will finance the deal with $6.8 billion in bank loans and $3 billion in junk bonds. In the meantime, Kraft's debt will surge from $1.15 billion to more than $12.4 billion. The whole debt-building move will obviously not add a thing to Kraft's ability to produce better or more competitive products, and it will saddle the company with huge expenses.

As an interesting aside, it might be well to note that the whole history of corporate mergers is not a good one. For instance, Phillip Morris has absorbed many different companies. But today 80% of MO's profits still comes from cigarettes.

One thing is clear -- the nation has now locked itself into a situation where any recession will be a disaster, a debt-crushing nightmare. The fact is that today's mountain of debt has put the Fed in a position where it cannot tolerate a recession. If you can't tolerate a recession, there's only one way you can go -- toward inflation.

To sum it up, the history of credit-driven financial manias is that they end up in disaster. Whether the current takeover frenzy will be any different remains to be seen.

Question: Can the Fed, through pumping up reserves and lowering interest rates, prevent a recession?

Answer: In my opinion, no. But they can try, and that's where the potential for inflation comes in. As I see it, the markets, particularly the debt markets, are too big and too sophisticated for the Fed to manipulate. At any sign of a concerted move by the Fed to pump up the US money supply, the debt markets will panic, thereby pushing up interest rates. As interest rates rise, the losses to bonds, mortgages, stocks, and money instruments of all kinds would be so huge that those losses would offset any gains produced by a pumped-up money supply.

Of course, in the event of a Fed pumping operation the dollar would swoon, and that too would militate toward higher interest rates and losses in all markets. That should give you some idea of the incredible dangers inherent in a leveraged America, an America that, year after year, is living beyond its means

Question: What can we, as individual investors, do to help the nation?

Answer: This may sound callous or selfish, but one thing we can do is stay solvent. When this bear market finally hits bottom, it's the solvent people, the people who have managed to hold onto their assets, who will come in and buy. That buying will establish the bottom for the next primary bull market. So my answer to this question fits in with the classic concept of capitalism -- by helping yourself, you will help the nation. As the bear market wears on, this nation is going to need solvent investors. And that's what I want my subscribers to be.

Question: In a recent magazine article I read that John Templeton, probably the most successful mutual fund manager in history, stated that he thought the bear market could already be over and that golden times lay ahead. What do you say to that?

Answer: I say more power to John Templeton. Enthusiasm and bullishness are great attributes, and Templeton sure possesses those traits. But one thing I've learned in this business is that anyone, regardless of his past record, can be dead wrong on the market. I read the Templeton article with interest, but in all humility I must admit that the only thing I trust is my own reading of the market and my own conclusions regarding the market.

I've been in this business a long time, and I know how tempting it is to listen and believe the views of those who have been outstandingly successful. But the market is bigger than any man or any group of men. I'd love to see Templeton right for the good of the nation, but I know that he can be just as wrong as anyone else. I listen and read a lot about a lot of people, but in the end my only authority is the market. And as I read the market, the bear is in command.

Question: Russell, the stock market has risen in the last quarter of every election year over the last 10 elections. Doesn't that almost guarantee that it will do it again this year?

Answer: Not necessarily. The more times a market repeats itself in a given situation, the better the odds are that the series is nearing an end. This logic applies to almost everything in the market. Example: The more right calls a market advisor makes, the nearer he is to making a wrong call. This is particularly true (for some ironic reason) whenever a given statistical series gains a large amount of publicity or whenever an advisor gathers too large a following.

Question: I'm fascinated with the stock market, have studied diligently, and want to start an advisory service. Do you think that's a good idea?

Answer: I never encourage or discourage anybody from entering this business. But believe me, this is one tough business. Consider this: In the US investment world there are nearly 50 million shareholders, maybe 150,000 hard-core readers of market advisories, and nearly 1,000 market letters of all types and varieties. In New Orleans last month Bob Prechter, Stan Weinstein and I were discussing this business. Between the three of us we know about everybody in the advisory area. I asked the question, "How many market reports do you think make real money for their publishers?" The most we could come up with was six reports. There may be a few more, but we couldn't think of them. Six really profitable reports out of a universe of 50 million shareholders? What are the odds? You'd do better going out for quarterback in the NFL. The odds on making it in this business aren't exactly glowing, but if you have the urge to tell other people how to manage their money, well, try it.

Question: Russell, if this is a bear market why don't you recommend shorts?

Answer: I don't recommend shorts because (and I've learned this from long experience) most people lose money on the short side. When you short a stock you are always speculating. Time is no ally of the short seller. Unlike an investor who is sitting through a bull market and collecting dividends while waiting, when you're short you are paying out dividends and learning that time is not on your side. In other words, ideally, the market would collapse a day after a trader put out his shorts. Every day the market holds up is a day of exasperation for the short seller. In other words, near-term timing is critical in short selling, and near-term timing is very, very difficult.

NOTES AND QUOTES: Election talk: The word is that "it's over." Bush is in. Since Reconstruction days no Democrat has won the presidency without taking Texas. Dukakis is on record for strict gun control. In my wildest dreams I can't envision a gun control candidate winning in Texas. Dukakis is coming over as soft on crime and presenting no overwhelming reason for people to switch. California is actually two states, but Southern Calif. is so pro-Bush that it will probably swing the whole state. Finally, there's no way Dukakis can win if he loses Texas and California. With 76 electoral votes between them, TX and CA now control 28% of all the electoral votes.

What about the market and a Bush win? I think Wall Street is now discounting a Bush win. So don't be surprised if it sells off on "the good news" right after the election.

Speaking of the election, the London *Economist* refers to the winner as President Bushakis, and it does so to emphasize that fact that no matter who wins, the problems our next president must face will be the same. The problems -- cutting the federal deficit -- raising taxes, cutting the trade deficit, making cuts in entitlements and defense.

* *

The pressure is on the US Big Three auto makers. And it's coming from Japanese auto production from inside the US. Ponder this: In 1983 Japan produced 55,000 cars in the US. In 1985 the figure rose to 145,000. In 1987 it rose to 324,000. This year Toyota and Mitsubishi is joining Honda, Nissan, and Mazda and the total will jump to 900,000. So Detroit not only faces an onslaught from abroad but from inside the US. As of late 1988 Japan now is producing almost as many cars in the US as the Chrysler Corp. By 1992 analysts predict that Japan will be producing 2.2 million vehicles a year in the US and Canada. At that point, Japanese-US production is expected to eat into the domestic share of the US market. Furthermore, the world's auto industry is on the verge of producing more cars than the world can use. To put it mildly, competition in the auto industry is going to get very rough.

* *

I'm a lefty, and I'm glad to see that George Bush is a lefty too (we lefties need all the clout in high places that we can get). Truman was a lefty as was Gerald Ford and James Garfield.

* *

Listen, nobody can say that the Russell kids don't get around. A few weeks ago my daughter Betsy's fiancee, Vince Van Patten, played demonstration tennis for the Reagans. Here's Betsy telling Nancy that she likes Vince a lot. Well, I should hope so!

* *

The price of those football franchises keep climbing. Most recent sales: Seattle Seahawks to Ken Behring (Calif. land developer) for a reported $99 million, the New England Patriots to Victor Kian (he owns Remington shavers) for $85 million. The Dallas Cowboys are for sale for around $100 million plus the cost of the stadium.

* *

The takeover mania on Wall Street is hitting industrial bonds hard. Takeovers vastly increase a company's debt structure, making the company's bonds much less secure. With no one knowing which company is next on the "hit list," bonds of the major corporations are sliding in price. The Eurobond market has practically ground to a halt as Europeans have stopped their buying of the bonds of major US corporations (example: bonds of RJR Nabisco have fallen 16 points recently).

* *

Catastrophic Health Care: Beginning January 1 seniors 65 or over eligible for Medicare will face a stiff new tax. The '89 rate will be $22.50 for each $150 of income tax they owe. Maximum tax will be $800 on an income tax of $5,400. The tax will be boosted to $37.50 on $150 of taxes in 1990, then to $42 on $150 of taxes in 1993.

* *

San Diego is becoming the West Coast's Miami, and La Jolla is becoming the home of choice for hundreds of Mexico's millionaires. The newcomers are lawyers, bankers, architects, politicians from Mexico's largest cities, and they are here to protect themselves against political uncertainty and a collapsing peso. Most have bought luxurious homes and their kids go to private schools. But aside from that they tend to keep a low profile.

* *

Oranges are the fruit that Americans eat the most of, but few know anything about oranges. Prior to 1500 oranges were a bitter fruit, used only for seasoning meat. In 1635 a sweet orange was introduced in China, and it was an immediate success. Oranges were introduced to the US by the Spanish and Portugese. Virtually no oranges are grown from seed; they are grafted onto lemon stock. Orange trees produce after four or five years and can produce for up to 50 years. Unlike apples, pears, and bananas, oranges will not ripen after they are picked. Unripe oranges look like a cup of rice on the inside and are inedible. The color of an orange has nothing to do with its ripeness. A green orange can be sweet and juicy.

* *

Time-Bomb: Of the nation's 3,000 S&Ls, half are losing money (over $7 billion lost so far this year) and over 500 are insolvent. The following is a comment from Herbert Sandler, CEO of the World Savings and Loan Assoc., before the Senate Banking Committee: "We are in a big, black bottomless pit, which is getting bigger every day. We are told, 'Don't worry, it's under control.' Well, it's not under control, and everyone who's conversant with the facts knows it. On the most conservative basis, the losses are at least $60 to $80 billion, and I wouldn't be surprised if it were $100 billion. Probably the greatest financial scandal in US history, a ticking time bomb that is ready to blow."

* *

The nation's newspapers are under a profit siege, with leading papers' profits down an average of 20% for the latest quarter. One reason is a drop in advertising since the crash. A second reason is the rise in newsprint prices. Here's a short history of newsprint prices per metric ton in the US: 1970, $173; 1973, $197; 1975, $307; 1978, $353; 1980, $440; 1982, $469; 1984, $500; 1985, $535; 1986, $570; 1987, $600, and 1988, $630.

* *

Statistics: 48 firms in the US are now working on cardiovascular drugs. . . . Employee benefit costs (Social Security and health insurance) are up 6.7% this year, wages and benefits are up 3.9%. . . . Average price of a San Diego County home (resale) is up 18% over the last 12 months to $169,105. . . . Most expensive area in the nation, coastal La Jolla where the average house now sells for $1.1 million. . . . The world is piling up oil in inventory at the rate of 200,000 barrels a day.

* *

What's coming up for autos in the 1990s? A variety of electronically-controlled innovations including anti-locking brakes, anti-slip traction (preventing wheels from spinning on slippery roads), computers that control the way a car leans when it goes around corners, six-speed gear boxes and variable transmissions (which constantly provide optimum gear ratios).

* *

If you buy a Treasury issue, how will changes in current interest rates affect that bond? The table below provides the answer. For instance, if you buy a note maturing in 7 years and yielding 9.2%, a rise of 1% in current rates will result in a drop of 4.9% in the market value of your note.

		Change in Price if interest Rates Go	
		Up 1	Down1
Maturity	Yield	Percentage Pt.	Percentage Pt.
3 Months	7.2%	- 0.2%	+ 0.2%
6 Months	7.9%	- 0.5%	+ 0.5%
1 Year	8.3%	- 1.1%	+ 1.1%
2 Years	8.7%	- 1.8%	+ 1.8%
4 Years	9.0%	- 3.2%	+ 3.3%
7 Years	9.2%	- 4.9%	+ 5.2%
10 Years	9.4%	- 6.2%	+ 6.7%
20 Years	9.4%	- 8.0%	+ 9.1%
30 Years	9.4%	- 9.2%	+ 10.9%

* *

I wasn't present at the funeral of Henry Ford II, but it must have been a bit out of the ordinary. Henry liked to run things, and even from the grave he gave specific instructions. In his will Ford instructed: "There should be music and warmth of fellowship and, in this connection, a black jazz bank playing 'When the Saints Come Marching In' for a recessional, for I do not wish to be remembered only in solemn fashion."

* *

I continue to believe that Russia will be forced to cut back on its military if it is to make any progress on the home-production front. Gorbachev has described the Soviet economy as being in a state of "pre-crisis." But one reason is that Russia spends as much as 25% of its GNP on the military and on supporting its military allies abroad.

A major problem for Russia is one that isn't often discussed -- its "worthless," non-convertible Russian ruble. No Western nation will accept rubles. Oil, Russia's chief export, is usually sold on a barter basis. Before the ruble can be made convertible into other currencies, the Russians would have to fill their own shelves and start manufacturing useful products that the world wants. The key to real perestroika is a convertible ruble, and a convertible ruble would seem to be years into the future.

GOLD: I probably receive 10 pounds of gold news, gold information, gold charts, gold reports, gold tomes and hard-money newsletters each week. The net of all this paper is that nobody has the slightest idea of where gold is going, and few have any idea of the purpose of gold as a store of value.

There are three concepts about gold I'd like to get over to subscribers in this Letter. The first is that intelligent, conservative investors find it prudent to own some gold. If they're worried about the chances of the Fed (somewhere ahead) trying to bail us out of a debt-collapsing recession by booming the money supply, then these investors might have as much as 10% to 15% of their assets in gold.

If they think that the next recession (and there will be one) will set off crushing deflation, then these investors also know that that kind of deflation will place many of our already shaky financial institutions in the bankruptcy column. In that case, gold in the vault will be mighty comforting.

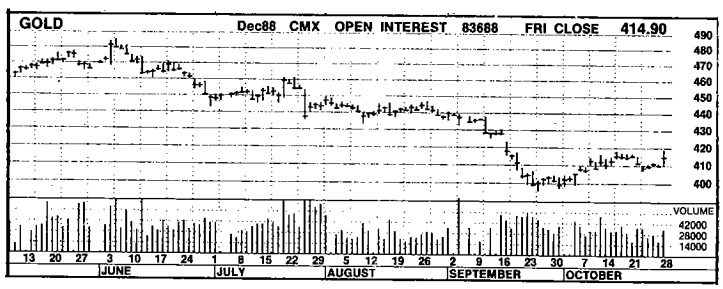
If these same worried conservatives believe that the next recession will topple the dollar to new and almost unthinkable lows, then they darn sure will want to fill their bank vault with Krugerrands, Maples Leafs, and American Eagles.

So that's concept No. 1, the idea that intelligent people want to own some gold. The second concept is this: Almost every year gold hits a low during the fourth quarter and then rallies into the first quarter (and sometimes it keeps rallying into the second and third quarters).

If I had to guess I'd guess that the 389 figure of last September was the low for 1988. Not that I care, mind you, because I've been telling my subscribers to buy bullion gold coins on a fixed-dollar amount each month, and we're already getting less gold for our bucks than we did only two months ago. Let me put it this way: If you were nuts about baseball cards, already owned a good collection, but you wanted to collect every card from the year 1930 to date, would you want the price of cards to go up or down? Right, you'd like the price to stay down for a while, but if the price went up that's OK too.

Here's my third comment about gold. Today we hear a lot of talk about new mines and an oversupply of gold. But remember this -- when gold makes its move, it will move on sentiment. During 1978-80 we used to say that "there's no fever like gold fever." People weren't talking about supply/demand, they were talking about inflation and how to get their hands on gold at any price. Let some emergency come up, and you'll see how quickly the supply/demand thesis is forgotten. Supply/demand figures for gold may make some sense when nothing is happening on the gold front. But, as I say, when gold moves, it moves because people are grabbing for it, lusting for it. You'll see that kind of action again before the debt-laden 20th century ends. Count on it, readers, count on it.

This daily chart of the December gold contract shows you what's been happening to gold over the last few months. On the contract, we see a decline leading to a double-bottom bounce off 400, a rise (last week) to over 410, then some sideways movement. On any further weakness, I would expect 400 to hold. By the way, platinum, often a metals leader, is looking strong (chart courtesy of *Investor's Daily*).



LATE NOTES: The dollar has turned weak. Over the last few weeks the Dollar Index has lost 39% of the gains piled up during its sharp January to August rally. Despite the weak dollar (and this is rather surprising), bonds have been strong with the Municipal Bond Index hitting new 1988 highs almost every day last week. Those of you who own munis should track this index (it's listed daily in the commodity section of most newspapers).

Meanwhile, the stock market continues on its erratic and schizophrenic course. The Dow hit a post-crash recovery high (2183.50) as recently as October 21. Again the A-D ratio refused to confirm. Furthermore, the A-D line for the 30 Dow stocks continues to act very poorly. At the October 21 Dow high the Dow's own A-D line failed by a wide margin to confirm. This tells us that fewer and fewer of the Dow Industrials are involved in producing the new recovery highs in the Average (obviously, not a bullish picture).

Relative strength on both the Amex and the NASDAQ has turned very weak. On the NYSE each rally is showing less and less buying power. There's an old market adage which states that "it takes real buying to put the market up, but stocks can drop of their own weight." And a dearth of buying is what we've been witnessing in the general market over recent months.

But a steady ebb in buying interest will (sooner or later) bring out the sellers. And this is what I expect to see in the period ahead -- perhaps starting a week or so after the election.

NEXT MAILING: Nov. 16